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SUBJECT: BRAZIL: INTERNAL POLITICAL UPDATE, WEEK OF 23-27  
JANUARY 2006

¶1. INTRODUCTION. Henceforth, post's regular series reporting on the political scandals affecting Brazilian politics will be expanded to include coverage of key developments in the 2006 election campaign, which is getting under way. In addition to updates on the corruption scandals and investigations, the cable will incorporate information on electoral legislation, emerging party alliances, poll results, and other factors in the 2006 national elections. The standing subject line, per above, will reflect the expanded content. This week's cable will provide background information on the coming races, electoral legislation and party negotiations to define coalitions and alliances, as well as report on Finance Minister Palocci's appearance before a congressional committee investigating corruption. END INTRODUCTION.

#### BRAZILIAN ELECTION PRIMER

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¶2. (U) The 2006 Brazilian electoral cycle will begin formally on April 1, when prospective candidates that are not running for reelection have to resign (e.g., the case of Sao Paulo Mayor Jose Serra and Sao Paulo Governor Geraldo Alckmin, both from the PSDB). However, parties are already negotiating alliances and coalitions, and a cabinet shuffle is expected in either February or March, since many ministers intend to run for office. The following offices will be elected in 2006: president and vice-president; one-third of the federal senators; all federal deputies; all state governors and vice-governors; all deputies to state legislatures. Elections for mayors and city councilmen will only take place in 2008. In the executive races (president and governor), there is a possibility of a second-round runoff three weeks after the first round if no candidate receives more than 50 percent of the valid votes. The legislative races are proportional and will be decided on October 1.

#### NO MORE "VERTICALIZATION"

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¶3. (U) Brazilian law establishes that elections are regulated by the legislation in force one year before the election day. However, on January 25, the Brazilian Chamber of Deputies approved a constitutional amendment that struck down a Superior Electoral Court (TSE) rule that established that party alliances in the states should follow those at the federal level (a rule known as "verticalization"). In practice, the rule required that if

two parties were allied in the presidential race, they would also have to be allied in the governor and federal deputy races. The amendment to strike down the rule (approved by the Senate in earlier votes) received 343 votes in favor, 146 against, and one abstention. The minimum required for a constitutional amendment to pass is 308, but it still must go to a second vote in the Chamber. After the vote, some legislators and lawyers stated that the new rule does not apply to this year's election, since it was established only nine months before the race. Brazil's association of attorneys have challenged the legality of the amendment's taking effect this year, and the Supreme Court (STF) may be called to decide the matter.

¶4. (U) If the Supreme Court ratifies the Chamber's decision, all parties -- more than 30 currently registered in the TSE -- will be free to follow their local and regional directories' interests, which tend to be more parochial and less ideologically-led than their national counterparts. The four large parties were split during the vote: the Brazilian Democratic Movement Party (PMDB) and the Liberal Front Party (PFL) were the most favored by the new rule. The PMDB will be allowed to launch an independent presidential candidate (either former Rio de Janeiro governor Garotinho or Rio Grande do Sul governor Germano Rigotto), while the PFL, although allied with the PSDB at the federal level, will be free to ally itself with different parties in state races. The Brazilian Social-Democratic Party (PSDB) and the Worker's Party (PT) had less to gain. PT allies (PSB, PCdoB, PTB, PP, and PL) will probably abandon the alliance at the state level, diminishing the chances for party victories regionally. At the federal level, however, President Lula da Silva reportedly favored the amendment, seeing it as a means for

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drawing more parties to his federal coalition.

ELECTION POLL: LULA LEADS AGAIN AFTER FIVE MONTHS  
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¶5. (U) On January 19, IBOPE released its latest poll on the presidential election. For the first time in five months, Lula rose to first place, giving signs that he may be recovering somewhat from the damage caused by the corruption scandals. According to the poll, Lula would beat Sao Paulo mayor Jose Serra by a 35 to 31 percent vote margin. The previous IBOPE poll, released in December, showed that Serra had 37 percent support, while Lula had 31 percent. IBOPE stated it did not ask how respondents would vote in a second-round run-off. However, the weekly news magazine Veja reported that IBOPE did, in fact, ask respondents how they would vote in a second-round, and figures published by Veja show Serra leading with 45 percent support, vice Lula with 42 percent. Although neither Lula nor Serra have publicly announced whether they will run for office, the poll suggests it is early to make any predictions on the election results.

THIS WEEK IN CONGRESS: PALOCCI TESTIFIES BEFORE CPI  
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¶6. (U) After months of negotiations and threats from the opposition, Finance Minister Antonio Palocci testified before the CPI on Corruption in Binges and Municipalities on January 26. Palocci appeared as an invited guest, thus avoiding a CPI subpoena. Federal Deputies bombarded Palocci with questions regarding a range of allegations against him, including of intervention in favor of U.S. company Gtech in a lottery contract with state-owned Caixa Economica Federal, corruption in bid letting in city government while he was mayor of Riberao Preto, and illegal transfer of funds from Cuba for use in the PT 2002 presidential campaign. Palocci denied all the allegations categorically, adding that he will not run for any office in this year's elections. In his testimony, Palocci, who

was Lula's 2002 campaign coordinator, stated that the Lula campaign did not use off-the-books financing (although the PT party's ex-Treasurer, the discredited Delubio Soares has admitted to another CPI that it did), declared that the PT did not receive any campaign money from Cuba, and claimed that the allegations against him were fanciful.

¶7. (U) Palocci denied the accusation that he had intervened in the contract renewal negotiations between GTech and Caixa Economica Federal (i.e., the Federal Savings Bank) in ¶2003. Palocci tried to distance himself from the accusation by saying that it was not his job to interfere in the bank's day to day management. Nevertheless, the cloud over him remains. According to a finding in the partial report of the CPI, Ademirson Ariovaldo da Silva, Palocci's former chief of staff, along with current Caixa Economica President Jorge Matoso and two former presidents of the institution, Sergio Cutolo and Emilio Carazzai, violated their statutory responsibilities and failed to comply with the applicable laws governing public procurement with respect to the GTech contract. Palocci's testimony was a non-event for the financial markets, which appear no longer to be concerned about a pre-election economic policy shift; the Real appreciated, the Sao Paulo stock exchange (BOVESPA) was up and measures of country risk were down.

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